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Agenda Item 3a

June 13, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Adoption of Real Assets Policy – Real Estate Program
- II. **PROGRAM:** Real Assets
- III. **RECOMMENDATION:** Recommend to the Investment Committee Adoption of the Statement of Investment Policy for Real Assets – Real Estate Program

IV. ANALYSIS:

Background

In May 2011, the Investment Policy Subcommittee recommended to the Investment Committee ("Committee") adoption of the Statement of Investment Policy for Real Assets, including proposed revisions to the Real Estate program policy. After discussion, the Committee requested that staff draft further revisions to the proposed Real Estate program policy and bring it back for consideration in June 2011.

In collaboration with the General Pension Consultant, Wilshire; Board Real Estate Consultant, Pension Consulting Alliance ("PCA"); and the INVO Legal Office; staff developed the revised proposed Real Estate program policy and submits it for review and adoption. This cover memo highlights revisions made to the proposed policy from the Policy Subcommittee's recommended draft in May 2011 and necessary revisions to other areas of the Real Assets policy to effectuate the proposed Real Estate revisions.

List of Attachments

- Attachment 1 - Proposed Revised Real Assets Policy
- Attachment 2 - Proposed Revised Real Assets Policy Glossary
- Attachment 3 - Wilshire Associates Opinion Letter
- Attachment 4 - Pension Consulting Alliance Opinion Letter

Summary of Proposed Revisions

Revisions to the proposed Real Estate policy are limited to 1) removal of the policy "waiver" clause, 2) institution of Interim Portfolio Limits in lieu of the "waiver" clause, 3) removal and incorporation into the parent Real Estate policy

of program attachments with specific policy requirements including repeal and incorporation of the stand alone Agriculture policy, 4) glossary and other minor revisions necessary to effectuate (1) through (3) above, and 5) minor edits and recommendations noted by staff during the deliberative process. Further detail is provided below.

1. **Removal of “waiver” clause.** Per discussion during the May 2011 Committee meeting and after continued deliberation between staff and consultants, staff recommends removal of the proposed policy exception language formerly specified in Section V of the Real Estate attachment.
2. **Interim Portfolio Limits.** In order to enable staff to implement the new Strategic Plan and optimize the Legacy Portfolio during an anticipated five to seven year transition period to compliance with long-term strategic limits in policy, staff recommends approval of two stages of interim portfolio limits in lieu of the former policy exception language.

The proposed interim limits consist of two graduated sets of limits that address two separate time periods. These interim limits will govern the specific policy parameter areas for the time periods specified and allow for wider discretion in the specified areas during the overall transition period. The initial period of wider interim limits will sunset after two years after which a second level of interim limits will go into effect that are more restrictive than the initial limits but still more liberal than the strategic long-term limits. After the second two-year period of interim limits sunsets, the strategic long-term limits will apply. Staff will provide the Committee with quarterly updates concerning compliance with both the applicable interim policy limits as well as the strategic long-term limits.

3. **Programs with Specific Policy Requirements and Related Policies.** Staff recommends removal and incorporation into the parent Real Estate policy of program attachments with specific policy requirements. The specific program attachments are 1) Attachment A – For Sale Residential Land Development Program, 2) Attachment B – California Urban Real Estate Program, and 3) Attachment C – Public Real Estate Securities Program. Staff also recommends repeal and incorporation of the current stand alone Agricultural Land Real Estate Program policy into the parent Real Estate policy.

The removal or repeal as separate attachments or stand alone policy documents and corresponding incorporation into the proposed parent policy document will remove dated policy language that includes historical policy exception language and serve to streamline and simplify the overall Real Estate policy.

The existing real estate policy for the Responsible Contractor Program ("RCP") will remain in effect as a stand-alone policy. Staff is scheduled to present a revised RCP draft to the Policy Subcommittee in 2011.

- 4. Other Items.** Proposed revisions include necessary changes to the Real Assets parent policy and glossary to effectuate the recommended revisions in (1) through (3) above. Additionally, minor edits and clean-up items noted by staff during the deliberative process are included.

Board Real Estate Consultant Review

The Board Real Estate Consultant, PCA, has reviewed and concurs with staff's recommendation. PCA will be available at the Committee meeting to answer any questions Committee members may have regarding the revised proposed policy.

V. STRATEGIC PLAN:

The revised proposed Real Assets policy will further the following CalPERS Strategic Plan goals:

- Goal VIII. Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.
- Goal IX. Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

At this time the Investment Office does not anticipate any additional cost needed to implement the proposed revised Real Assets policy.

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